S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **WISCONSIN ELECTRIC POWER COMPANY** for approval, pursuant to MCL 460.6q, of the sale of its interest in the Edgewater 5 Generating Unit.	)	Case No. U-16366

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on December 4, 2012.

Exceptions, if any, must be filed with the Michigan Public Service Commission, 4300 West Saginaw, Lansing, Michigan 48917, and served on all other parties of record on or before December 18, 2012, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before January 4, 2013. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark E. Cummins

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Mark E. Cummins
Administrative Law Judge

December 4, 2012
Lansing, Michigan

S T A T E O F M I C H I G A N

MICHIGAN ADMINISTRATIVE HEARING SYSTEM

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On June 8, 2010, Wisconsin Electric Power Company (Wisconsin Electric) filed an application--with supporting testimony and exhibits--requesting approval concerning the proposed sale of its 25% ownership interest in the coal-fired Edgewater Unit 5 (Edgewater-5) to Wisconsin Power and Light Company (WP&L), pursuant to Section 6q of 2008 PA 286, MCL 460.6q (Section 6q). According to the documentation filed in support of Wisconsin Electric's application, the underlying reason for the asset's sale was to avoid making additional investment in environmental control equipment for Edgewater-5, which the utility claimed would serve to increase the company's revenue requirements to a level in excess of the projected revenue requirements that would otherwise result from either the plant's retirement or sale (with replacement energy coming from some other source).

Pursuant to due notice, a prehearing conference was held on July 13, 2010, before Administrative Law Judge Mark E. Cummins (ALJ). In the course of that prehearing, the ALJ granted the joint petition to intervene filed on behalf of Tilden Mining Company, L.C., and Empire Mining Partnership (collectively, the Mines). The Commission Staff (Staff) also participated in the proceedings. Subsequently, the parties signed and submitted a protective order governing the use and disclosure of confidential materials--most of which related directly to the Asset Sales Agreement (ASA) between Wisconsin Electric and WP&L.[1] The protective order was approved and entered by the ALJ on July 14, 2010.

In compliance with the schedule demanded by Section 6q(5), the initial evidentiary hearings in this matter took place on September 9, 2010.[2] In the course of those initial hearings, testimony was received from three witnesses, two on behalf of

[1] Wisconsin Electric is a Wisconsin corporation engaged in the business of providing wholesale and retail electric services in areas located both in Wisconsin and in the Upper Peninsula of Michigan. WP&L is likewise a Wisconsin corporation, but one which distributes electricity solely within the state of Wisconsin. See, 2 Tr 23. At the time this proceeding was initiated, Wisconsin Electric owned an undivided 25% interest in Edgewater-5, while WP&L owned the remaining undivided 75% interest; moreover, pursuant to a 1983 Ownership Agreement (OA) entered into by these two entities, WP&L had operational responsibility for the facility. Id.

[2] In addition to this proceeding, Wisconsin Electric and WP&L jointly filed requests for approval of the proposed asset sale with both the Public Service Commission of Wisconsin (PSCW) and the Federal Energy Regulatory Commission (FERC) in May of 2010. According to Wisconsin Electric (and, at least on the date its brief was filed in the initial phase of this case), the status of those two cases was as follows:

> On June 15, 2010, the PSCW issued a Notice of Investigation indicating that it would not hold a hearing on the Joint Application absent a request, and no request for a hearing was made. On August 30, 2010, the PSCW Staff filed its memorandum on the Application and set a due date for comments of September 15, 2010. As of the filing of this brief, only Wisconsin Electric and WP&L filed comments. The PCSW has not yet ruled on the Joint Application.
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> * * *
>
> The FERC [in Docket No. EC10-69-000] granted its approval of the sale in an order dated June 29, 2010. On July 21, 2010, Wisconsin Electric file a copy of this decision in the instant proceeding.

Wisconsin Electric's initial brief, dated September 20, 2010, p. 10.

Wisconsin Electric and one from the Mines. No witnesses were presented on behalf of the Staff at that time. Based on the agreement of the parties, none of those witnesses was cross-examined; rather, the direct testimony of each was simply bound into the record.

The resultant record arising from those proceedings consisted of 85 pages of transcript and 36 exhibits, each of which was received into evidence (and 16 of which received confidential treatment).[3] Pursuant to the expedited schedule that was initially established for this case, each of the three parties filed briefs on September 20, 2010. On September 27, 2010, Wisconsin Electric and the Staff also filed reply briefs, whereas the Mines submitted a letter to the Commission's Executive Secretary indicating that they would not be submitting a separate reply brief. Consistent with the initial schedule set for completion of this case in accordance with Section 6q(5), the ALJ issued his initial PFD on October 14, 2010.

Based on the record assembled to that point, the initial PFD recommended that the Commission hold that insufficient proof had been provided to justify approving the ASA as it stood. That conclusion was based on the ALJ's belief that neither the first nor the fifth criteria set forth in Section 6q(7) had been fully satisfied, at least by the record developed at that juncture. Nevertheless, the ALJ went on to indicate that record did appear adequate to support the agreement's approval so long as certain conditions were imposed on the sale of Wisconsin Electric's share of Edgewater-5. The initial PFD went on to discuss each of the three general conditions proposed by parties to this case

[3] Certain portions of the record have been given confidential treatment and are thus contained in separate volumes of the transcript. However, because a vast majority of the information referenced in the current Proposal for Decision (PFD) is actually found in the public version of the transcript, the citations contained herein are to the public version only.

for imposition of the ASA. These concerned: (1) a request by both the Staff and the Mines to impose interim rate credits reflecting reductions in plant-related and general expenses, as well as their proposed treatment of accumulated depreciation; (2) the suggestion by those two parties that the Commission condition any approval of the plant's sale upon receipt of a firm commitment from Wisconsin Electric that it would never seek recovery from Michigan ratepayers of any expenses associated with Edgewater-5's pre-closing liabilities; and (3) the Staff's proposal to condition any approval of the ASA on the explicit agreement by Wisconsin Electric to sell, and by WP&L to buy, the utility's 25% share of Edgewater-5 at a substantially higher price than set forth in the ASA.[4]

Following his discussion regarding the efficacy of adopting those and other proposals, the ALJ recommended that the Commission "approve the ASA between Wisconsin Electric and WP&L, but condition such approval on the utility's agreement to provide its Michigan ratepayers with a rate credit in the amount of $457,912 annually," which was intended to "reflect all reductions in plant-related and general expenses expected to arise from the asset's transfer." See, PFD, pp. 30-31. Specifically, the initial PFD suggested accepting--at least for use in the present case--the $39 million purchase price set forth in the ASA, while concurrently rejecting all other proposals offered by the parties, including requiring the utility to commit to never seek rate recovery of costs arising from Edgewater-5's pre-closing liabilities, placing a cap on the

[4] Specifically, while the ASA was based on a price of approximately $39 million, the Staff estimated that a figure in the range of $60 million was more representative of the asset's true value. In reaching that conclusion, the Staff asserted, among other things, that the price agreed to by Wisconsin Electric and reflected in the ASA was suppressed by the fact that the utility (1) elected to only solicit interest in its part ownership from a few regional utilities, (2) chose not to publish a notice concerning its desire to sell this asset, and (3) decided not to use a third party to seek interest from other potential buyers.

recovery of such costs, and imposing a rate credit relating to the plant's net salvage value.

On December 2, 2010, the Commission issued an order in this proceeding (the December 2 Order) essentially concurring with the initial PFD in all aspects except for one. Namely, the Commission concluded that because Wisconsin Electric's marketing efforts "were not as wide reaching as they should have been," the utility should "impute a higher purchase price for the sole purpose of appropriately measuring the impact and value of the proposed transaction with respect to Michigan retail customers." December 2 Order, p. 13. The Commission thus found that "approval of the ASA should be conditioned upon [Wisconsin Electric's] agreement to an imputed purchase price of $60 million," in addition to the company's implementation of "a $457,912 annual rate credit for its Michigan customers." Id., pp. 14-15.

On January 3, 2011, Wisconsin Electric filed a petition for rehearing, pursuant to Rule 403 of the Commission's Rules of Practice and Procedure, R 460.17403, claiming that the December 2 Order contained erroneous findings of fact and conclusions of law. Specifically, the utility asserted that the Commission erred as a matter of law by conditioning its approval of the sale on the Company's agreement to apply an imputed purchase price of $60 million, as opposed to the $39 million price set forth in the ASA. See, Wisconsin Electric's January 3, 2011 petition for rehearing, p. 1. The utility thus requested that the Commission (1) remove the condition that the utility agree to the higher imputed purchase price for purposes of ratemaking, and (2) approve the sale without the imputed price. See, Id., p. 2. While the Company's petition was pending, it

proceeded with the transaction and closed the sale of its interest in Edgewood-5 to WP&L, with such closing taking place on March 1, 2011. See, 4 Tr 225.

On April 26, 2011, the Commission issued an order in this case granting, at least in part, Wisconsin Electric's petition (the April 26 order). In so doing, it stated that:

> The Commission continues to find that [Wisconsin Electric] failed to engage in marketing efforts that supported the proposed [$39 million] purchase price. Where WP&L has a financial interest in being the only viable offer, it is reasonable for the Commission to impute income to the seller in order to protect ratepayers. However, the Commission agrees with [Wisconsin Electric] that the record evidence was also insufficient to support the $60 million imputed price. The Commission, therefore, reopens record in this proceeding, in order to allow the ALJ to take additional evidence on the issue of what the imputed value of the asset should be for ratemaking purposes only. The case is remanded to the ALJ to set another prehearing conference, and to thereafter schedule dates for an evidentiary hearing and briefing.

April 26 order, p. 8.

Based on that order, a second prehearing conference was held on June 14, 2011, to set a schedule for the reopened portion of this proceeding. In accordance with that schedule, the utility filed direct testimony and exhibits on July 29, 2011, sponsored by Richard L. Levitan and John T.W. Mercer. On September 23, 2011, the Mines and the Staff filed direct testimony and exhibits prepared by Michael Gorman and Harshleen Sandhu, respectively. Finally, on November 1, 2011, Wisconsin Electric filed rebuttal testimony sponsored by Mr. Levitan and Christine T. Akkala.[5] Evidentiary hearings in the reopened portion of this case were conducted on November 29, 2011, which, when coupled with those previously held in this matter, resulted in a total record consisting of

[5] On November 16, 2011, the Mines filed Motions to Strike the entire rehearing testimony and exhibits offered by Mr. Mercer, as well as certain portions of the testimony and exhibits submitted by Ms. Akkala. On the same date, the Staff filed a Motion to Strike a small portion of Mr. Levitan's rebuttal testimony. Prior to the start of cross-examination in the reopened portion of this case, Wisconsin Electric agreed to the Staff's request, and that Motion was granted. See, 4 Tr 102-103. However, after hearing argument from the parties with regard to the Mine's requests, the ALJ ultimately denied both of those Motions. See, 4 Tr 113-115.

399 pages of transcript and 102 exhibits. Subsequently, each of the parties filed briefs and reply briefs regarding the reopened portion of this proceeding.

II.

STATUTORY REQUIREMENTS AND PRIOR DECISIONS

As noted on pages 3 through 5 of the initial PFD, Section 6q constitutes Michigan's recently-enacted public utilities mergers, acquisitions, and divestitures law. That portion of the statute begins by stating, in Subsection (1), that:

> A person shall not acquire, control, or merge, directly or indirectly, in whole or in part, with a jurisdictional regulated utility nor shall a jurisdictional regulated utility sell, assign, transfer, or encumber its assets to another person without first applying to and receiving the approval of the commission.

MCL 460.6q(1). In deciding whether or not to approve a proposed action covered by this law, Section 6q(7) directs that "the commission shall consider among other factors" all of the following:

(a) Whether the proposed action would have an adverse impact on the rates of the customers affected by the acquisition, transfer, merger, or encumbrance.

(b) Whether the proposed action would have an adverse impact on the provision of safe, reliable, and adequate energy service in this state.

(c) Whether the action will result in the subsidization of a non-regulated activity of the new entity through the rates paid by the customers of the jurisdictional regulated utility.

(d) Whether the action will significantly impair the jurisdictional regulated utility's ability to raise necessary capital or to maintain a reasonable capital structure.

(e) Whether the action is otherwise inconsistent with public policy and interest.

MCL 460.6q(7). Moreover, Sections 6q(8) and 6q(9) expressly allow the Commission to "impose reasonable terms and conditions" on the proposed transaction to protect either the jurisdictional regulated utility or its customers, while concurrently allowing the utility to "reject the terms and conditions imposed by the commission and not proceed with the transaction." MCL 460.6q(7) and (8).

As also noted in the initial PFD, only a handful of cases have been filed with the Commission pursuant to Section 6q. The first was in Case No. U-16029, in which Upper Peninsula Power Company (UPPCO) and Alger Delta Cooperative Electric Association (Alger Delta) submitted a joint request for approval of the transfer of the Nahma distribution line from UPPCO to Alger Delta. No parties intervened in that case, and the matter was resolved through approval of a settlement agreement concerning the proposed transfer. See, November 12, 2010 order in Case No. U-16029. The second was in Case No. U-16035, where Wisconsin Energy Corporation (WEC), Edison Sault Electric Company (Edison Sault), and Cloverland Electric Cooperative (Cloverland) jointly sought approval of WEC's proposed sale--and Cloverland's purchase--of 100% of WEC's equity interest in Edison Sault. Once again, that case was resolved via settlement agreement, albeit with Cloverland agreeing to certain restrictions concerning the Board of Director representation concerning the new, combined utility. See, e.g., April 27, 2010 order in Case No. U-16035, Attachment A. As such, and as pointed out in the initial PFD, the present case constitutes the first fully-litigated proceeding processed under the new law concerning mergers, acquisitions, and divestitures.

III.

TESTIMONY AND POSITIONS OF THE PARTIES

As noted earlier, Wisconsin Electric offered testimony from three witnesses in the course of the reopened proceedings. The first of these was Mr. Levitan, who provided, among other things, his estimate of the true market value of the utility's 25% interest in Edgewater-5 at the time that the sale was being considered. See, 4 Tr 124-125. In support of his estimate, Mr. Levitan explained the two methodologies he employed, those being the "standard discounted cash flow (DCF) analysis" and the "comparable sales" method. See, id., at 125. Beginning with his belief that the asset could only be marketed to a "merchant generator"--as opposed to a regulated investor-owned utility (IOU)--who would then "sell energy and capacity into the [Midwest Independent System Operator (MISO)] market" at wholesale rates, Mr. Levitan asserted that the value of Wisconsin Electric's minority interest in the plant would be greatly influenced by myriad factors. 4 Tr 142. Although indicating that the two most important issues were whether Edgewater-5's operating life would be extended beyond the current 2021 expiration date set forth in the underlying OA and the impact of new environmental requirements placed on coal-fired generating plants, he went on to discuss the potential effect of various other factors like (1) the weak market for electric capacity in the MISO region, (2) the change in the projected price of natural gas versus coal delivered to power plants located in Wisconsin, and (3) various terms and conditions, beyond the issue of the facility's operating life that the OA signed by Wisconsin Electric and WP&L would impose on a third-party purchaser. See, 4 Tr 133-140 and 161-164. Based on the

results of his DCF analysis, Mr. Levitan concluded that "a prospective buyer" would offer approximately $38.1 million for [the utility's] 25% interest in Edgewater-5." 4 Tr 161.

Mr. Levitan went on to address the comparable prices of coal-fired plant assets actually sold in the region during the period 2007 through 2009, all of which are listed on Exhibit A-28. He began by noting that, with regard to those asset transfers, none "is just like [the sale of] Edgewater-5." 4 Tr 166. Nevertheless, despite pointing out that the list of transactions that were at least somewhat similar to that involving Edgewater-5 was also very limited, and discounting the sales of output from the Kyger Creek and Clifty Creek coal-fired plants to Buckeye Power Generating, LLC (Buckeye) because the transaction occurred outside the 2007-2009 period, Mr. Levitan concluded that "the average of the cohort group [of plant sales prices] represents 92% of the price" that Wisconsin Electric received from WP&L for its 25% interest in Edgewater-5. Id. According to him, this supports his belief that the utility received fair market value for its share of the plant. See, Id.

The Company's second witness to testify during the reopened portion of this case was Mr. Mercer, who addressed the reasonableness of Wisconsin Electric's marketing efforts regarding the asset sale in question. Mr. Mercer began by describing "the market norm for marketing a minority undivided interest in an electric generating unit," which he asserted stands "in sharp contrast to the market standard . . . for the sale of 100 percent of the ownership interest in a generating plant." 4 Tr 200-201. According to Mr. Mercer, although the marketing plan for the proposed sale of a 100% interest in a generating plant is typically conducted through a widely-noticed Request for Proposal (RFP) or some similar process, the same is not true when the sale involves a

minority interest, like that being offered by Wisconsin Electric. See, 4 Tr 201-203. Rather, he continued, the market norm for the sale of a minority interest is generally through use of a privately negotiated transaction, as opposed to being conducted through use of the RFP process. See, Id. This is, Mr. Mercer contends, due to the fact that "a prospective purchaser of a minority undivided ownership interest will have to live with a large number of complications and limitations on the use and management of its asset." 4 Tr 202.

Mr. Mercer then followed up with a discussion of the factors specific to the Edgewater-5 asset sale that he felt made it "a particularly poor candidate . . . to realize any benefit from an auction-style marketing arrangement," such as through employment of the RFP process. 4 Tr 205. Most of those factors arose from the high level of control that the OA covering the plant's operation gave to WP&L, including the possible steps that WP&L might elect to take in response to the application of both current and future environmental standards on not only Edgewater-5, but on WP&L's other generating units. See, 4 Tr 205-208. According to Mr. Mercer, factors such as those "made the sale of the asset essentially unmarketable to any other party than WP&L." Id., p. 209.

The final witness sponsored by Wisconsin Electric was Ms. Akkala, whose rebuttal testimony primarily responded to concerns expressed by witnesses for both the Mines and the Staff with regard to the end-of-service date used by Mr. Levitan in the course of his DCF analysis. Ms. Akkala pointed out that, although attempts were made to persuade WP&L to amend the OA to extend the end of service date for Edgewater-5 beyond the existing December 31, 2021 expiration date, WP&L refused to do so. See, 4 Tr 212-213. According to her, this refusal was likely prompted by "significant

uncertainties regarding the future operation of coal-fueled units" like Edgewater-5, which included both "anticipated environmental regulations covering air emissions, land use and ash, and water use" arising from operating such a unit, as well as the fact that WP&L had already "received a Notice of Violation" from the United States Environmental Protection Agency regarding this and other generating plants. Id., at 213-214. Ms. Akkala concluded her testimony by stating that, despite assertions by the Mine's witness that Wisconsin Electric could certainly have sold its 25% interest in Edgewater-5 to either an IOU or some municipal electric utility, it appeared that few of those entities actually needed additional capacity at the time of the proposed sale, and that the possibility of selling any excess capacity into the MISO system was unlikely. See, 4 Tr 214-217.

Based on the evidence offered by its witnesses on the reopened record, the utility contends that: (1) a wider marketing effort would not have resulted in a greater purchase price; (2) the DCF analysis performed by Mr. Levitan shows that the most reasonable present market value for Wisconsin Electric's 25% interest in Edgewater-5 at the time of its sale was $38.1 million; and (3) because the Company actually received more from WP&L for its share of the plant than estimated by Mr. Levitan (i.e., approximately $39 million), no imputed purchase price adjustment is warranted in this case. As a result, it appears that the utility is currently asking, as it did in its petition for rehearing, that the Commission adopt the $39 million sales price figure contained in the ASA as reasonable, as opposed to assigning the $60 million imputed price arrived at in the December 2 order (or any other figure proposed by either the Mines or the Staff).

For their part, the Mines offered additional testimony from Mr. Gorman in the course of the reopened proceedings. Mr. Gorman began by asserting that a close examination of Mr. Levitan's DCF analysis reveals that it drastically undervalued Wisconsin Electric's 25% ownership interest in Edgewater-5, to the point of making it more financially beneficial for its ratepayers to have kept the asset as opposed to selling it to WP&L for $39 million. Specifically, he testified that "customers would have been better off" if Wisconsin Electric retained ownership of its 25% share of Edgewater-5 and simply "sold the output of the plant into the wholesale market." 4 Tr 229. Under his "continued ownership scenario," the results of which were produced by simply adjusting Mr. Levitan's DCF analysis to assume that a regulated IOU (such as Wisconsin Electric) owned the facility, as opposed to an unregulated merchant generator (whose greater level of debt in its overall capital structure would lead to a higher cost of capital), the asset's implied market value would have been at least several million dollars higher. See, 4 Tr 229-231.

Nevertheless, Mr. Gorman expressed additional concerns regarding the inputs to Mr. Levitan's DCF analysis, beyond the assumption that a merchant generator would be the likely purchaser. He thus proposed a few other adjustments to the initial DCF-based computations, with the key one being assuming a significantly later end-of-service date for Edgewater-5 than was assumed by Mr. Levitan when conducting his analysis . See, 4 Tr 231-233.

In addition to employing a modified DCF analysis, Mr. Gorman performed his own comparable asset sales analysis. In so doing, he asserted that only one of the generator plant sale transactions that Mr. Levitan relied on "was worthy of consideration

in comparison to [Edgewater-5]," namely that involving the Kyger Creek units mentioned above. 4 Tr 247. After setting forth the reasons for disqualifying the other plants, and adjusting the Kyger Creek sale price to account for a difference in environmental abatement equipment between those units and Edgewater-5, he arrived at a figure approximately twice as high as that suggested by Mr. Levitan's comparable sales analysis.

Finally, Mr. Gorman performed what he referred to as a "reproduction cost less depreciation comparison to the existing unit" analysis. 4 Tr 249. According to him:

> This methodology entails estimating the cost of installing a new unit, and adjusting the service life for that unit to the remaining life of the comparable unit. Other adjustments would be necessary, such as reducing the cost of a new unit by [the expense of selected catalytic reduction and flue gas desulfurization equipment], in order to provide a comparable unit technology perspective to [Edgewater-5].

4 Tr 249. Mr. Gorman went on to testify that this analysis produced an imputed value for Wisconsin Electric's 25% interest in Edgewater-5 that is roughly three times the $39 million sales price set forth in the ASA (as well as the $38.1 million figure resulting from Mr. Levitan's DCF analysis). See, Id., at 250.

Based on a weighted average of the two DCF analyses he performed (for which he gave 20% weight to the one assuming a 2021 plant retirement and 80% to the one based on a later retirement), the results of his comparable asset sales analysis, and his reproduction cost less depreciation comparison, Mr. Gorman arrived at an imputed value figure of $86.4 million. See, 4 Tr 223-224. In light of that testimony, the Mines recommend that the Commission set the imputed value of Wisconsin Electric's 25% share of Edgewater-5 at $86.4 million.

The final witness to testify was the Staff's Harshleen Sandhu, an analyst in the Financial Analysis and Customer Choice Section of the Commission's Regulated Energy Division, who provided additional testimony regarding what the most reasonable imputed value should be for Wisconsin Electric's former 25% interest in Edgewater-5, at least for ratemaking purposes.[6] See, 4 Tr 257. In so doing, she concluded that certain assumptions made by Mr. Levitan in the course of his DCF analysis needed to be revised, based on the realities of the situation as it stood at the time of the proposed asset sale. According to her, the most questionable assumption used in Mr. Levitan's DCF model was "that the purchaser of Edgewater-5 would be an unregulated merchant generator subject to MISO operating requirements." 4 Tr 259. Ms. Sandhu's assertions in this regard were based, in large part, on the fact that Wisconsin Electric's own solicitation efforts were largely focused on regulated regional utilities, as opposed to more geographically-dispersed merchant generators. See, 4 Tr 258-259.

Based on her conclusion that the most likely, if not only, purchaser of the utility's 25% interest in Edgewater-5 would be a regulated IOU, Ms. Sandhu testified that three significant adjustments need to be made to Mr. Levitan's DCF model inputs.[7] The first recommended adjustment was to reduce the necessary Return on Equity (ROE) input from 15% to 10.25%, the second was to reduce the long-term debt cost from 7.75% to 5.0%, and the third was to substitute a 50/50 debt to equity ratio for the 65/35 ratio used

[6] Ms. Sandhu also testified that neither she nor the Staff would be addressing the testimony of Mr. Mercer regarding either the market norm for attempting to sell a minority interest or the specific factors that might effect such an attempt with regard to the utility's 25% interest in Edgewater-5. According to her, the Staff "does not see any reason to address Mr. Mercer's testimony since the Commission did not reopen this record to take additional evidence on the solicitation process." 4 Tr 257.

[7] According to her, the Staff "prepared a range of reasonable values by which to input into the DCF model," thus producing a "low-value and high-value" range of reasonableness, but went on to target a specific value for each input in order to arrive at a single recommendation regarding the most accurate imputed value for the asset. 4 Tr 260.

by Mr. Levitan. See, 4 Tr 261-262. Considering the effect of all three above-stated adjustments, she concluded that $49.3 million constitutes "a just and reasonable imputed value for ratemaking purposes" arising from the asset in question. 4 Tr 263. Finally, Ms. Sandhu opined that should the Commission elect to consider establishing the asset's value assuming an extension of the OA beyond the currently-established end of service date, the value would rise significantly.[8] See, Id.

Based on Ms. Sandhu's testimony regarding the adjustments that needed to be made to Mr. Levitan's DCF analysis, the Staff "recommends $49.3 million as a just and reasonable imputed value" for Wisconsin Electric's 25% interest in Edgewater-5. Staff's initial brief, p. 11. As asserted by the Staff, this figure "falls within a range of the low and high values that the Staff recommends as reasonable inputs to the Company's DCF model." Id., p. 10, citing 4 Tr 263. Although the Staff did offer a position on what the appropriate imputed value would have been should the OA be extended by 10 years (which it concluded would result in an imputed value ranging from $89.5 to $102.5 million), it continued to advocate for the adoption of the $49.3 million figure initially proposed by Ms. Sandhu. See, Staff's reply brief, p. 6.

IV.

DISCUSSION AND FINDINGS

From all of the above, it appears that no new disputes have arisen during the reopened portion of this case with regard to the five specifically-enumerated factors set

[8] Specifically, Ms. Sandhu testified that although "Mr. Levitan's model estimates the fair market value of Edgewater-5 as $63.2 million when assuming an extension" of the OA, the Staff's "estimated fair market value of Edgewater-5 when assuming an extension of the [OA] and applying the Staff adjusted inputs [ranges] from $89.5 million to $102.5 million, with a target of $95.7 million." 4 Tr 264.

forth in Section 6q(7), at least as that provision applies to the sale of Wisconsin Electric's 25% interest in Edgewater-5. As directed by the Commission in the April 26 order, the parties have [at least for the most part][9] focused solely on the provision of additional evidence regarding "what the imputed value of the asset should be for ratemaking purposes only." April 26 order, p. 8. As a result, the only issue to be resolved is what specific figure should be assigned as the appropriate imputed asset value. Based on the totality of the record (including the evidence received during both the initial and reopened phases of this proceeding), the ALJ finds that the most reasonable figure to adopt is $49.3 million, as ultimately proposed by the Staff. See, Staff's initial brief, p. 11, and Staff's reply brief, p. 6. The ALJ's conclusion is based on three overriding factors, each of which is discussed below.

A. Most Reasonable Asset Valuation Methodology

As asserted by Wisconsin Electric, and apparently conceded by the Staff, the most reasonable method for establishing the appropriate price for the utility's 25% share of Edgewater-5 is through the application of a DCF analysis similar to that performed by

[9] Both the Mines and the Staff have asserted at times that the information offered on behalf of the utility concerning its marketing efforts was beyond the scope of the reopened proceedings. In support of their assertions, those two parties contend that nowhere in the April 26 order did the Commission state that its was reopening this record to take additional evidence on the reasonableness of the Company's bid solicitation process or marketing strategy as a whole. Rather, they cite the portion of that order which states that the Commission "continues to find that [Wisconsin Electric] failed to engage in marketing efforts that supported the proposed sale price." April 26 order, p. 8. Nevertheless, the testimony to which the Mines and the Staff appear to object (primarily that provided by Mr. Mercer), does serve a legitimate purpose. Namely, that testimony points out the various difficulties in actually finding a purchaser willing to pay substantially more for the utility's 25% interest in Edgewater-5 than WP&L ultimately paid, which--logically--has at least some effect on what the most accurate imputed price should be. Nevertheless, the ALJ disagrees with Wisconsin Electric's claim that a wider-ranging marketing effort would have had no chance of increasing the sales price for the asset in question. Rather, the ALJ believes that, by at least making a stronger effort to seek out, identify, and involve other potential purchasers, WP&L would have (being clearly interested in gaining full control of the facility) at least considered making a higher offer than the $39 million ultimately set forth in the ASA.

the Company's witness, Mr. Levitan. In reaching this conclusion, the ALJ notes that the other two valuation methodologies addressed by witnesses to this case (namely, the comparable sales method explained by Mr. Levitan, and the reproduction cost less depreciation comparison discussed by Mr. Gorman) appear ill suited to providing a reasonable imputed price for the asset in question.

For the comparable sales method, the record indicates that far too small of a comparison group was available to produce a figure to which any significant degree of confidence could be assigned. As Mr. Gorman pointed out, "there was only one comparable asset identified by Mr. Levitan that is reasonably comparable" to the sale of Edgewater-5, specifically the sale of the Kyger Creek units to Buckeye.[10] 4 Tr. 246. Moreover, even the Kyger Creek units differed substantially from Edgewater-5 in terms of both age and existing environmental compliance equipment. See, Id., at p. 248, citing Exhibits MIN-26 and MIN-27. Furthermore, even Mr. Levitan conceded that "comparable sales, alone, are generally not a sound basis for determining [the] market value of power plants," and are generally used by investors solely to perform a "gut check" regarding the reasonableness of any offer they might be considering. 4 Tr. 195.

With regard to the reproduction cost-based analysis discussed by the Mines' witness, significant concerns also exist. As noted by Mr. Levitan, that methodology "is generally not a sound basis for determining market value unless the property is relatively new [which Edgewood-5 is not] and other valuation approaches cannot be utilized [which they can]." 4 Tr. 196. Therefore, as with the comparable sales method

[10] In support of this assertion, Mr. Gorman described, on a sale by sale basis, why each of the other generating units included on Exhibit A-28 differed to such a degree from Edgewater-5 that those transactions could not reasonably be used as an accurate predictor of what price should have been received by Wisconsin Electric for the sale of its 25% interest in Edgewater-5. See, 4 Tr. 246-248.

addressed above, Mr. Gorman testified that the reproduction cost less depreciation comparison "should only be used as a check on the DCF valuation." Id. In addition, two significant errors were pointed out with regard to Mr. Gorman's application of this methodology. First, as noted in Mr. Levitan's rebuttal testimony, Mr. Gorman's initial calculations in this regard were suspect in that they (1) were based on the cost of the Sunderland Generating Station Unit 4, which he mistakenly concluded was to be a conventional coal-fired unit, when it was--in fact--designed to also burn various biomass fuels, and (2) failed to recognize that the plant was never actually built, thus making any figures regarding its construction cost patently speculative. See, Id., citing Exhibit A-35. Second, Mr. Gorman's calculation was based on the assumption that the OA covering Edgewood-5 would be extended to allow for a useful life of 50 years, an assumption which is specifically rejected later in this PFD.

As a result of the above discussion, the ALJ finds that application of the standard DCF analysis is the most appropriate methodology to be applied in this proceeding, and recommends that the Commission rule likewise.

B. Potential Sale to an Unregulated Merchant Generator

Notwithstanding Wisconsin Electric's continual claims to the contrary, both the Staff and the Mines correctly argue that, based on the record assembled in this case, there is no rational basis to assume that Edgewater-5 would be sold to an unregulated merchant generator (as opposed to a regulated IOU). See, Staff's initial brief, pp. 6-7; Mines' initial brief, pp. 9-10.

As pointed out by the Staff, although Wisconsin Electric assumed that "there would not be rate base or cost-of-service regulation associated with [Edgewater-5's]

sale of energy and capacity" in the MISO market, the utility provided "no support for its assumption." See, Staff's initial brief, p. 6. Instead, and as the Staff's witness (Ms. Sandhu) correctly noted, information offered by the Company supports concluding that the opposite is true. For example, included in arguments offered by the utility during the initial phase of this proceeding is the assertion that "it is undisputed that [Wisconsin Electric's] efforts to solicit potential purchasers focused on . . . regional utilities which Wisconsin Electric believed may be interested in purchasing the 25% interest." 4 Tr. 258-259, citing Wisconsin Electric's September 27, 2010 reply brief. Moreover, as Ms. Sandhu also testified, the Company's witness regarding valuation issues:

> conducted his analysis post-sale when actual facts about the potential purchasers and actual buyer were a known quantity. [WP&L], the actual buyer, is not an unregulated merchant generator. In addition, only one of the four entities that [Wisconsin Electric] had formal discussions with for [the sale of its interest in] Edgewater-5 was actually an unregulated merchant generator. With this pre-sale and post-sale information in hand, there is no basis to assume and value the plant as if the purchaser of Edgewater-5 would be an unregulated merchant generator.

4 Tr. 259 [citation's omitted; emphasis in original].

Also, and as correctly noted by the Mines, testimony provided on this matter by two of the utility's own witnesses was internally inconsistent. Specifically, Mr. Mercer stated that Wisconsin Electric's limited marketing efforts regarding the Edgewater-5 sale were reasonable because its interest in the asset was "essentially unmarketable to any party other than WP&L," which is a regulated IOU. 4 Tr. 209. In contrast, Mr. Levitan's analysis regarding the value of this asset focused on:

> how an unaffiliated private equity investor would value the cash flows associated with the sale of energy and capacity in the MISO market as a "merchant generator."

4 Tr 142. As astutely noted by the Mines, It is "contradictory" for the Company to simultaneously proclaim that its interest in Edgewater-5 "was essentially unmarketable to any party other than WP&L or a few regional utilities," on the one hand, and that the asset's value "should be determined from a merchant generator perspective," on the other. Mines' reply brief, pp. 9-10.

In light of the above-noted factors, the ALJ agrees with the Staff and the Mines on this issue, and finds that the record fails to support the utility's assumption that its interest in Edgewater-5 would likely be sold to an unregulated merchant generator, as opposed to a regulated IOU. The ALJ therefore recommends that the Commission ultimately find that, based on the totality of the record, the valuation of the asset in question should assume that the potential purchaser would be a regulated IOU.

C. Proposed Adjustments to the Utility's DCF Computation

Having concluded that the DCF analysis is the most appropriate valuation methodology to be applied in this proceeding, and having further concluded that such an analysis should assume that the likely purchaser would be a regulated IOU, the final area of discussion concerns four requested adjustments to the analysis performed by Mr. Levitan. Each of these proposed adjustments (three of which were initially requested by the Staff, and one of which was primarily advocated by the Mines) are addressed below.

1. Reducing the ROE Input

Simply stated, ROE measures the amount of after-tax profit that a company generates with the money its shareholders have invested in its operations. As noted

above, the DCF model used by Mr. Levitan to estimate the value of Wisconsin Electric's ownership interest in Edgewater-5 assumes an ROE of 15%.[11] However, as the Staff's witness--Ms. Sandhu--pointed out, the Company's use of an assumed 15% ROE input was "based on the underlying assumption that the purchaser would be an unregulated merchant generator." 4 Tr. 261.

In contrast, the Staff asserts that the ROE-related input used in conducting the DCF analysis for this asset should reflect the fact that "the plant was marketed to utilities, purchased by a utility, and was [always] most likely to be purchased by a utility." Id. As a result, the Staff advocates employing an assumed ROE consistent with that generally granted to regulated IOUs. Specifically, the Staff proposed adopting 10.25% as the ROE to be applied in this proceeding, which Ms. Sandhu testified to be the mid-point of a reasonable range for regulated utilities running from 10% to 10.5%. See, Id.

The ALJ agrees with the Staff that the 10.25% ROE input should be adopted for use in conducting the DCF analysis needed to estimate the true value of Wisconsin Electric's 25% interest in Edgewater-5. Because the most likely purchaser was, all along, a regulated IOU, the ALJ finds it unreasonable for Mr. Levitan to have used an ROE input level corresponding to the return expected by an unregulated merchant generator. Moreover, the specific ROE level suggested by the Staff--namely 10.25%--represents the average awarded ROE set forth in the Edison Electric Institute's Rate Case Summary for the second quarter of 2011 (which covers the period immediately following the closing date for the asset's sale to WP&L). See, 4 Tr 261, fn. 6. The ALJ

[11] For his part, the Mines' witness, Mr. Gorman, asserted that his analysis of the likely ROE to be demanded of an unregulated merchant generator's investors was approximately 12%, as opposed to the 15% figure espoused by Mr. Levitan. See, 4 Tr 242-243. However, as discussed elsewhere in this PFD, the fact that the utility's interest in Edgewater-5 would almost certainly be purchased by a regulated IOU makes any review of the appropriate ROE for a merchant generator moot.

therefore recommends that the Commission adopt the Staff's suggested 10.25% ROE input when determining the asset's actual value at the time of its sale to WP&L.[12]

2. Appropriate Long-Term Debt Cost

The cost rate for long-term debt (essentially, the effective interest rate that an entity pays on all loans and other financial obligations having a duration of over one year) is generally an important component of a utility-related company's overall cost of capital. In this case, Wisconsin Electric's witness pointed out that "[r]elative to regulated utilities . . . , merchant generators have higher costs of capital and limited ability to issue debt due to the risks of selling power into competitive wholesale markets." 4 Tr. 144-145. Again, based on its assumption that the ultimate purchaser of the utility's 25% share of the Edgewater-5 facility would be an unregulated merchant generator, the Company supported using a relatively high figure (namely, 7.75%) for the expected cost of the purchasing entity's long-term debt. See, 4 Tr 145-146.

For her part, the Staff's witness asserted that a more realistic range for the purchaser's long-term debt cost input would be, at least in this case, between 4.5% and 5.5%. See, 4 Tr 261. Specifically, Ms. Sandhu again testified that using the mid-point of that range (namely, 5.0%) would make the most sense. According to her, reducing this input from the Company's suggested level was necessary to reflect the fact that Wisconsin Electric's share of Edgewater-5 was most certainly going to be--and ultimately was--purchased by a regulated utility, as opposed to an unregulated

[12] Although the Mines' witness also suggested using a reduced ROE input (specifically,10.4%) for any purchase of the asset by a regulated IOU, Mr. Gorman's suggested figure was based on "an industry average return on common equity [for] calendar year 2010." 4 Tr 245. Because the Staff's figure was based on data covering a timeframe that was closer to the asset's actual transfer date, the ALJ finds the Staff's suggested figure to be the more accurate of the two.

merchant generator. See, Id. The Mines' witness, Mr. Gorman, essentially agreed with Ms. Sandhu's assessment that the Company's proposed figure of 7.75% was far too high. See, 2 Tr 245. Although not discussing this matter in significant detail, he indicated that the marginal cost of debt for an average regulated IOU during 2010 "was around 6.0%." Id.

As with the prior issue, the ALJ agrees with the Staff and finds that its suggested long-term debt figure--specifically, 5.0%--should be adopted for use in conducting the DCF analysis regarding Wisconsin Electric's share of Edgewater-5. This conclusion is based on the following three factors. First, and as previously discussed, the 7.75% figure proposed by Wisconsin Electric erroneously assumes that the purchaser would be an unregulated merchant generator. Second, the long-term debt figure testified to by Ms. Sandhu was, as noted in the record, "based on recent debt market rates throughout the industry." 4 Tr 261. Third, her figure most closely comports with the cost of long-term debt recently adopted by the Commission for use in computing Wisconsin Electric's own electric rates, which was 5.31%. See, the June 26, 2012 order in Case No. U-16830, at p. 14. As a result, the ALJ recommends adopting the Staff's suggested rate of 5.0% for use as the cost of long-term debt when computing the true value of the Company's interest in Edgewater-5.

3. Assumed Debt-to-Equity Ratio

A company's debt-to-equity ratio reflects the respective portions of its overall capital structure that consists of long- and short-term debt (on the one hand) and invested or retained equity (on the other). In conducting his DCF analysis for Wisconsin Electric, Mr. Levitan assumed that the purchasing entity's capital structure would consist

of approximately 65% debt and 35% equity. This was, once again, in keeping with his assumption that the utility's 25% share of Edgewater-5 would be purchased by an unregulated merchant generator. See, 4 Tr 262. Specifically, based on his examination of the capital structure for five merchant generators, Mr. Levitan found that his proxy group had "an average debt-to-total capitalization ratio of 65%." 4 Tr 145, citing Exhibit A-18.

The Staff's witness, as well as the witness testifying on behalf of the Mines, took issue with the 65/35 debt-to-equity ratio suggested by the utility. As before, these witnesses noted that because the only likely purchaser of Wisconsin Electric's ownership interest in Edgewater-5 would be a regulated IOU, a significantly lower ratio should be used in conducting the DCF analysis. Specifically, Ms. Sandhu testified that, "based on recent utility industry data," a 50/50 debt-to-equity ratio should be used for that purpose. 4 Tr 262. Mr. Gorman agreed fully, stating that "a common equity ratio of 50%" should be employed instead of the Company's 65/35 ratio. 4 Tr 245.

The ALJ agrees with the Staff and the Mines, and concludes that the most accurate debt-to-equity ratio to be applied in this situation is the 50/50 ratio proposed by Ms. Sandhu and Mr. Gorman. Once more, because it was highly unlikely that the asset would be purchased by a merchant generator, the ratio used in Mr. Levitan's analysis must be rejected in favor of one which better corresponds to that of a regulated IOU. Moreover, use of the 50/50 ratio suggested by the Staff and the Mines for this purpose comports with the Average Common Equity ratio reflected in the AUS Monthly Report for September 2011, as well as the figure reflected in the *Regulatory Focus* published by the Regulatory Research Associates on July 5, 2011. See, 4 Tr 245 and 262. The

ALJ thus recommends that the Commission adopt, for use in this proceeding, the 50/50 debt-to-equity ratio advocated by the Staff and accepted by the Mines.

4. Extension of the Facility's Operating Life

As noted earlier, a significant difference in the estimated value of the utility's ownership interest in Edgewater-5 arises if one assumes that the cash flow derived from future use of the asset would extend beyond its currently-established retirement date. According to Wisconsin Electric's witness, Mr. Levitan, the 2021 expiration date of the Company's existing OA with WP&L is the most reasonable date to use in assessing the true duration of the asset's value. In contrast, the Mines contend that the facility's 1985 in-service date, when coupled with "the typical 50+ year life of a coal-fired generating plant," shows that the Commission should assume "a much longer potential plant life" than that claimed by the Company. Mines' reply brief, p. 12. Among other things, the Mines claim that such an assumption is supported by the fact that the depreciation rates that the utility proposed to--and which were ultimately approved by-- the Commission in Case No. U-16231 reflect an expectation that Edgewater-5 will continue to operate through at least 2035 or 2040. See, 4 Tr 235-236.

Notwithstanding the Mine's claims to the contrary, the ALJ does not find that sufficient record evidence exists for concluding that a longer period should be assumed for the potential cash flow arising from the utility's 25% interest in Edgewater-5 than the period upon which Mr. Levitan's DCF analysis was based. The conclusion is based on the following four factors.

First, and as noted by the Mines themselves, the investment horizon relied upon by Mr. Levitan--which ends on December 31, 2021--is consistent with the current

expiration date contained in the OA between the utility and WP&L. See, the Mines' reply brief, pp. 11-12. Second, it appears that when a potential purchaser requested having the term of the OA extended, the request was rejected by WP&L, leading that entity to withdraw its tentative purchase offer and cease negotiating further. See, i.e., Wisconsin Electric's initial brief, p. 35, and its reply brief, p. 11. Third, Mr. Gorman failed to cite a single instance in which a purchaser of a minority interest in a generating facility essentially agreed to double the potential price of that interest on the mere assumption that the operating term relating to the facility would be extended. Fourth, and maybe even more telling, is Mr. Gorman's own admission that: (a) the projection of an asset's average service life for use in setting depreciation rates is nothing more than "an estimate;" (b) that estimate "is not intended to represent a definitive or guaranteed retirement date" for the asset in question; and (c) generating units like Edgewater-5 "may retire at dates that are different than, both before and after, their original estimated retirement dates." Exhibit A-47.

In light of the above-stated factors, the ALJ finds that the Commission should reject the Mines' request to assume, for purposes of estimating the most accurate value for the Company's 25% interest in Edgewater-5, a much longer operating horizon than that assumed by Mr. Levitan in conducting his DCF analysis. When considered in conjunction with the other findings set forth in this section of the PFD, the ALJ recommends that the Commission begin with the DCF analysis conducted by Wisconsin Electric's witness, make each of the three adjustments proposed by the Staff's witness (Ms. Sandhu), reject the change in the facility's operating period proposed by the Mines'

witness (Mr. Gorman), and ultimately adopt $49.3 million as the most reasonable imputed value for the utility's 25% interest in Edgewater-5.

V.

CONCLUSION

Based on the foregoing, the ALJ recommends that the Commission issue an order regarding the reopened portion of this case that adopts the findings and conclusions set forth above. It is therefore recommended that the figure of $49.3 million be imputed by the Commission as most representative of the true value of Wisconsin Electric's 25% ownership interest in Edgewater-5 at the time of that asset's sale.

Finally, it should be noted that any arguments or potential issues not specifically addressed in this PFD were deemed to be irrelevant to the ALJ's ultimate findings and conclusions.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark E. Cummins

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Mark E. Cummins
Administrative Law Judge

December 4, 2012
Lansing, Michigan